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# DEVINE ENTERTAINMENT CORPORATION

ANNUAL REPORT 1998



DEVINE ENTERTAINMENT  
CORPORATION



## CONTENTS

Mission Statement	
Corporate Profile	
1998 Awards & Highlights	1
Letter to Shareholders	2
Program Library	4
Management's Discussion and Analysis of Financial Condition and Results of Operations	7
Consolidated Financial Statements	11
Corporate Information	

ANNUAL REPORT 1998

## MISSION STATEMENT

Devine Entertainment is committed to producing the best children's and family television entertainment programs and to distributing them to the international marketplace. We plan to grow by expanding our production and by increasing sales around the globe.

## CORPORATE PROFILE

Devine Entertainment is dedicated to:

- Building up our "brand" of high quality, live-action children's and family programs
- Capitalizing on new opportunities in family and children's markets worldwide
- Expanding our market reach through traditional distribution and through the internet
- Continuing to work with the best artistic and technical talent that can be found (Devine Entertainment provides work for more than 300 full-time, contract and freelance employees)
- Increasing the value of the company and its assets (DVN on the Toronto Stock Exchange)

Cover: *L'étoile* (The Star) by Edgar Degas



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## 1998 AWARDS & HIGHLIGHTS

**JANUARY** - *Galileo: On the Shoulders of Giants*, starring Michael Moriarty, premieres on HBO.

**FEBRUARY** - *Einstein: Light to the Power of 2* receives two SciFest honours: the APASE Award from the Association for the Advancement of Science in Education and the Youth Jury Award for "Most Inspiring Film".

**MARCH** - Agreement reached with Time Warner's HBO to produce *The Artists' Specials*, a six-part series featuring the lives of famous artists.

**APRIL** - Hal Leonard Corporation signs agreement to distribute *The Composers' Specials* to the specialty music market in the U.S. and around the world.

**MAY** - Over 170 Public Television stations in the U.S. sign on to broadcast *The Composers' Specials* and *Beethoven Lives Upstairs* as part of a two-year license agreement.

**JUNE** - *Galileo: On the Shoulders of Giants* wins the Parents' Choice Video award. *Leonardo: A Dream of Flight* receives a KidsFirst! award from the Coalition for Quality Children's Media.

**JULY** - Devine Entertainment in association with Rollercoaster Studios begins development of an interactive educational history timeline: [www.devinetime.com](http://www.devinetime.com).

**AUGUST** - *Galileo: On the Shoulders of Giants* and *Leonardo: A Dream of Flight* are nominated for a total of five Gemini Awards. *Leonardo* wins for Best Writing in a Children's Special. Principal photography begins in Montreal on *The Artists' Specials*.

**SEPTEMBER** - PBS stations begin airing *The Composers' Specials* and *Beethoven Lives Upstairs*.

**OCTOBER** - The prestigious Chicago International Children's Film Festival screens *Galileo: On the Shoulders of Giants*.

**NOVEMBER** - *Einstein: Light to the Power of 2* wins the Alliance for Children & Television's Award of Excellence for Best Drama.

**DECEMBER** - PBS stations in the key markets of New York City and Philadelphia air *The Composers' Specials* in peak Christmas viewing slots. Two of *The Artists' Specials* films: *Degas* and the *Dancer* and *Monet: Shadow and Light* are delivered to HBO.



# LETTER TO SHAREHOLDERS

Devine Entertainment Corporation is a fully integrated developer and producer of live-action children's and family films. The Company's films target the global television and home video markets.

Our library presently consists of 19 original films and 15 CDs.

## BUILDING ON CREATIVITY AND INNOVATION

Fiscal 1998 was the year that inspiration and hard work began to bring recognition to our company. At press time, Devine Entertainment was nominated for nine Emmy awards for two of our *Inventors' Specials*: *Galileo: On the Shoulders of Giants* and *Edison: The Wizard of Light*.

In 1998, we also began production (in association with Rollercoaster Studios) of our new interactive website, [www.devinetime.com](http://www.devinetime.com). This site will enable young people and adults to explore the history of invention from Leonardo daVinci to Albert Einstein. Woven into the timeline will be numerous interactive games. Clips from our *Inventors' Specials* films will also be available on-line, adding some veracity to the experience.

Along with the website, we will implement an e-commerce store to sell our home video and CD products directly to the consumer. Both the timeline and the store will launch in the third quarter of 1999.

Continuing to build on the educational value of our film library, we are partnering with Hal Leonard Corporation to publish teachers' guides to accompany The Composers' Specials videos. Hal Leonard specializes in the music retail and educational market and began distributing The Composers' Specials videos in 1998. The guides are scheduled for publication in January 2000.



Geordie Johnson as Franz Liszt in *Liszt's Rhapsody*







Charlotte Sullivan as Katherine Cassatt in  
*Mary Cassatt: American Impressionist*

## LOOKING FORWARD

The year 1999 will see the production of three more films for HBO: *Goya: Awakened in a Dream*, *Rembrandt: Fathers and Sons* and *Winslow Homer: An American Original*. Our production of *Goya* and *Rembrandt* will take place in Slovakia and Moravia in the Czech Republic, while *Homer* will be produced in and around Toronto in August of 1999.

We have optioned several young adult novels and are presently developing many new movies and television series for the international market. We intend to expand our production output while increasing sales and marketing efforts.

Whenever we produce a new program, our library grows and its value increases. With our popular programs, global audience reach, and talented creative and management teams, Devine Entertainment will continue to build long term value.

The advice of our Board is very helpful and to all of our staff I want to express genuine appreciation. I would further like to thank our co-production partners, broadcasters, and shareholders who support us and who have all contributed to our success.

Devine Entertainment's films will continue to come to life for families to enjoy worldwide and we will move forward to establish Devine Entertainment as the leader in children's and family live-action entertainment.

*David Devine*

## DAVID DEVINE

President & Chief Executive Officer

April 30, 1999

## OUR KEY STRENGTHS

In 1998, we also sold seven programs, *Beethoven Lives Upstairs* and *The Composers' Specials* to 173 PBS stations. We successfully negotiated a 30-second tag commercial featuring our toll-free number (877-338-4633) to sell our home videos directly to viewers.

The year also saw the production and delivery of three more films for HBO and the production of three new CDs. Our *Artists' Specials* commenced production in Montreal in August of 1998. *Degas and the Dancer*, *Monet: Shadow and Light*, and *Mary Cassatt: American Impressionist* were produced successfully.

Alison Pill as Marie in  
*Degas and the Dancer*





# PROGRAM LIBRARY

## **A YOUNG CHILDREN'S CONCERT WITH RAFFI & RAFFI IN CONCERT WITH THE RISE AND SHINE BAND**

These videos feature the acclaimed children's entertainer, Raffi, in concert in front of an enthusiastic, live audience. Both videos have received numerous awards and have been certified multi-platinum.

## **BEETHOVEN LIVES UPSTAIRS**

Produced in 1992 as a broadcast special sold to Home Box Office in the U.S. and the Canadian Broadcasting Corporation (CBC), *Beethoven Lives Upstairs* became a phenomenal success. The film received worldwide critical acclaim and won a **1993 Primetime Emmy** for outstanding children's program.

The program describes the relationship between a young boy and an eccentric boarder, Ludwig van Beethoven, who has moved in upstairs. At first the boy resents the new tenant, but slowly he comes to understand the genius of the man, the torment of his deafness, and the beauty of his music. Set in 19th century Vienna, *Beethoven Lives Upstairs* is historically based and features excerpts of Beethoven's best-loved works.

## THE COMPOSERS' SPECIALS

These lush hour-long films follow the relationship between a fictional child and a great classical composer, blending traditional storytelling and classical music to create innovative viewing for families. Each entertaining story relates the human connection between child and composer.

### **BACH'S FIGHT FOR FREEDOM**

An independent boy reluctantly becomes assistant to the frustrated composer Johann Sebastian Bach. The temperamental composer recognizes a kindred soul in the young boy. Set in 1717, *Bach's Fight for Freedom* passionately argues that the only master you can serve faithfully is your own heart.

### **LISZT'S RHAPSODY**

The charming Franz Liszt takes on a gypsy boy as a music student and finds his own work transformed by the experience. A simple wager turns into a mighty struggle of wills: a conflict of freedom vs. discipline, heart vs. brain, and passion vs. technique.

### **ROSSINI'S GHOST**

A nine-year old girl witnesses Rossini's efforts to salvage his seemingly cursed new opera. Set in 1816, the year *The Barber of Seville* had its disastrous premiere, *Rossini's Ghost* reveals that friendship, like opera, requires nurturing, patience, and time.

## **STRAUSS: THE KING OF THREE QUARTER TIME**

A poor 10-year-old stableboy discovers how much he has in common with the great Johann Strauss Jr. The composer and the boy discover the healing bond of trust and embark on a collaboration that will be music to the world's ears.

## **BIZET'S DREAM**

A 12-year-old Parisian girl takes piano lessons from Georges Bizet as he anguishes over his life and his latest opera. Set in 1875, *Bizet's Dream* tells the compelling and bittersweet story of a special friendship.

## **HANDEL'S LAST CHANCE**

A Dublin street kid is selected as choirboy for Handel's first performance of *The Messiah*. In the process, Jamie is befriended by the renowned composer, who suffers from a lack of self-esteem. When the boy is falsely accused of theft, Handel comes to his aid. The *Messiah*'s premiere brings Handel glory and restores him to his rightful place in the musical world.

## THE INVENTORS' SPECIALS

In each film, a young protagonist befriends a genius and both are transformed. With the series, Devine hopes to "turn on" a new generation of young people to the often eccentric and yet inspiring world of the great scientists and their inventions. Each of the films aims to illustrate that achievements in life, whether large or small, are usually the result of overcoming some sort of adversity.

### **EINSTEIN: LIGHT TO THE POWER OF 2**

An unlikely meeting of minds occurs in the 1950s when professor Albert Einstein comes to the rescue of an African-American girl. Nine-year-old Lannie is unmotivated, and her poor grades at school drive her struggling parents to despair. When Einstein's ideas about science ignite a spark in Lannie, she embarks on a voyage of self-discovery.

### **LEONARDO: A DREAM OF FLIGHT**

Set in Milan during the Renaissance, Leonardo da Vinci befriends young Roberto, son of a local bird seller. Leonardo's obligations as the Duke's court artist prevent him from working on a flying machine he has invented. Amidst political unrest and personal tragedy, young Roberto brings Leonardo a step closer to flight.







### ***GALILEO: ON THE SHOULDERS OF GIANTS***

In Padua at the dawn of the 17th century, Galileo pits science against theological doctrine by demonstrating that the earth moves in space. In the face of Church persecution, the young prince Cosimo de Medici defends his tutor's ideas. Inspired by Galileo's quest for scientific truth, Cosimo vows to follow him on the road to discovery.

### ***NEWTON: A TALE OF TWO ISAACS***

When his theory of gravity revolutionizes scientific thought in 1682, Isaac Newton pays a heavy price and is ostracized from the Royal Academy by his nemesis Robert Hooke. Isaac's young scribe Humphrey takes a universal, life-long lesson from Newton's struggle.

### ***MARIE CURIE: MORE THAN MEETS THE EYE***

During World War I, the young Boudreau sisters decide to aid the war effort by catching spies. The strange comings and goings of Nobel Prize winning scientist Marie Curie make her a prime suspect. When the girls follow Curie to the battlefield, they discover that she is actually using science to save lives.

### ***EDISON: THE WIZARD OF LIGHT***

1893, West Orange, NJ...Thomas Edison - the world's greatest inventor - is alone in his lab, obsessed by a vision: "What if I could do for the eye what my favorite invention, the phonograph, does for the ear?" Jack, a scruffy young boy fleeing a truant officer, crashes into the lab. Edison makes the boy his apprentice and they embark on an adventure that leads to the creation of the motion picture.

## **THE ARTISTS' SPECIALS**

Each of the six films features a legendary artist who, at a telling point in his or her life, crosses paths with a young person. From their meetings come stories that inform and entertain children and adults alike. Viewers see the famous works created by these artists and learn about their lives through their interactions with the children they befriend.

### ***DEGAS AND THE DANCER***

A struggling Degas is inspired by an aspiring young ballerina named Marie. Degas helps Marie tap into the talent she doesn't believe she has. At the same time, Marie convinces Degas to persevere despite criticism from the Parisian critics. As artist and model, they become friends and find in each other what they need to follow their dreams.

### ***MARY CASSATT: AMERICAN IMPRESSIONIST***

Cassatt's tidy life in Paris is disrupted when her brother's unruly kids arrive. But she soon finds herself inspired by the children and uses them as models. Her boy-crazy niece Katherine plays matchmaker between Cassatt and the great Degas. Romance does not blossom, but Degas invites Cassatt to join the Impressionists. Cassatt's feminist ideals greatly influence and change Katherine. Likewise, the children soften Cassatt, who renews ties with her family in Philadelphia.

### ***CLAUDE MONET: SHADOW AND LIGHT***

Near Paris in 1869, Monet paints light and colour in nature. He sells few works, but is committed to his art — driving his father to cut his allowance. Monet befriends Daniel, his landlady's son and aspiring artist. Daniel misses his father, who he believes has gone away to paint, and thus Monet becomes the boy's mentor. When Daniel learns that his father has abandoned him, he tries to run away but is stopped by Monet. Sharing these hard times, they teach each other the importance of family and of never giving up.

### ***REMBRANDT: FATHERS AND SONS***

At the height of Rembrandt's success as a portrait artist in 1630s Amsterdam, he takes on a young Jewish studio apprentice. The boy's struggle to break free of his family's rigid expectations lead the painter to wrestle with his own complacency, ending in his defiance of artistic convention with his daring masterpiece "The Night Watch," and a lifelong pursuit of his own vision.

### ***FRANCISCO DE GOYA: AWAKENED IN A DREAM***

At 73, Spanish painter Goya doesn't care about his reputation or the king. He wishes to paint alone at his country villa. Fate brings him a housekeeper whose young daughter has a passion for drawing. He shares his work with the girl and teaches her how to "see" as an artist. She helps him overcome his illness, and paves the way for reconciliation with his difficult only son. Together they keep the intrusive royals at bay as Goya completes his famous Black Paintings.

### ***WINSLOW HOMER: AN AMERICAN ORIGINAL***

The most famous American painter of his day, Winslow Homer was an artist with a distinctive eye who was able to capture the mood of rural and seaside America in a career which spanned the horrors of the Civil War and stretched into the 20th century. (In pre-production)



# PRODUCTION SCHEDULE

DEVINE'S LIBRARY OF FILMS

	pre-1994	1994	1995	1996	1997	1998	1999
<b>ARTISTS</b>							
Winslow Homer							
Rembrandt							
Goya							
Cassatt							
Monet							
Degas							
<b>INVENTORS</b>							
Edison							
Newton							
Curie							
Galileo							
Leonardo							
Einstein							
<b>COMPOSERS</b>							
Rossini							
Handel							
Liszt							
Strauss							
Bach							
Bizet							
Beethoven Lives Upstairs							
Raffi 2							
Raffi 1							
<b>Totals</b>	<b>3</b>	<b>1</b>	<b>5</b>	<b>0</b>	<b>5</b>	<b>3</b>	<b>4</b>
<b>Library Total: 21 films</b>							



# FINANCIAL REPORT

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### 1998 OVERVIEW

Devine Entertainment Corporation's activities in 1998 effected the continued growth of the Company's library of proprietary films and initiated important investments in a series of new production, distribution and marketing initiatives. These actions were taken with a view to increasing the Company's ability to exploit its library into the future. While the Company continued to be profitable in 1998, the cyclical nature of the Company's delivery schedule of new films saw reduced revenues and profits as compared with 1997. The Company expects that current contracts for the delivery of the final four films in *The Artists' Specials* will bring an increase in revenues and profits in 1999.

### FISCAL 1998 COMPARED TO FISCAL 1997

The Company's revenue for 1998 was \$2.1 million as compared to \$3.4 million for the year ended December 31, 1997, a year-over-year decrease of 38%. Earnings before income taxes were \$0.04 per share as compared to \$0.14 in 1997. Earnings per share in 1997 were \$0.021, a decrease of 74% from \$0.082 in 1997.

In keeping with the Company's strategy to focus on increasing the production of its own library of proprietary family programs, the Company completed the first two episodes in a new six-episode series of one-hour films, entitled *The Artists' Specials*. *Monet: Shadows and Light* and *Degas and the Dancer* were delivered in the fourth quarter of 1998. The Company produced the third film in the series, *Mary Cassatt: American Impressionist* and subsequently delivered the film to Home Box Office in the first quarter of 1999. The Company also delivered the final film in its previous series, *Edison: The Wizard of Light*, to HBO, Family Channel and the Multimedia Group of Canada earlier in the first quarter of 1998. The Company delivered a total of three films in 1998 as compared with five films in 1997. The Company expects to deliver four *Artists' Specials* films in 1999. Devine Entertainment recognized production and distribution revenues of \$1.7 million on the delivery of the three new films in 1998.



Financial results in any period depend on the Company's production and delivery schedule of television programs. Broadcasters typically make most of their annual programming commitments in the first and second quarter of the year, so that the first new programs will be ready for delivery in the third and fourth quarter of the year. The Company recognizes revenue when the finished product is delivered and accepted by the client and when the broadcast period begins. As a result, the Company's revenue is not recognized evenly throughout the year and a significant portion of such revenue is recognized in the fourth quarter. Consistent with the seasonal nature of the Company's business, the Company realized \$1.3 million in production and distribution revenue, or 62% of its total annual revenue, in the fourth quarter of 1998.



The Company's strategy is not only to focus on the production of its own programs to build its proprietary library of films and ancillary products, but also to produce programs with international appeal. In 1998 approximately 75% of the Company's revenues, or \$1.6 million, were derived from outside of Canada. This reflects the growing acceptance and awareness of the Company's films, specifically in the U.S., as well as the increased value a larger library of programs has in the international marketplace. It is also notable that subsequent to the end of 1998, two episodes of *The Inventors' Specials*, *Galileo: On the Shoulder's of Giants* and *Edison: The Wizard of Light*, were honored with an unprecedented nine Emmy nominations in the United States.

Shareholders' Equity increased by 2% in 1998 to \$10.3 million from \$10.1 million in 1997 and the Company's assets grew by \$2.4 million or 14% to \$19.2 million. Retained earnings were \$1,746,065 at the end of fiscal 1998.





Amortization of the Company's program library is determined based on the ratio that current revenues earned from the programs bear to the management's estimate of total gross revenue to be realized. Revenue estimates involve uncertainties and accordingly are reviewed on a quarterly basis.

Operating expenses increased 11% to \$513,984 in 1998 as compared with \$461,231 in 1997, reflecting the growth of the Company's in-house marketing activities as well as the costs of initiating a strategy of growth through strategic alliance and M&A activities with the assistance of contracted investment bankers.

Interest expenses increased to \$265,987 in 1998 as compared to \$37,738 in 1997 as a result of a shortfall in government-backed production financing and the delay in licensing the Company's new series in Canada. *The Artists' Specials* were subsequently licensed in Canada to YTV and TVO for delivery in 1999.

The development of a significant new internet entertainment and e-commerce venture in association with Bell Canada, Stentor and Rollercoaster Studios was not reflected in 1998's financial statements as non-recoupable advances from Bell and Stentor were used to offset the related expenses in 1998. The Company expects to launch a series of new internet applications in mid-1999.

## **FISCAL 1997 COMPARED TO FISCAL 1996**

Revenue in fiscal 1997 totaled \$3.4 million as compared to \$1.85 million in 1996. This increase reflected \$3.1 million in production and distribution revenues on the delivery of five new films in 1997.

The Company's income before taxes and interest in fiscal 1997 increased by approximately 24% to \$1,689,900 as compared with \$1,357,072 in fiscal 1996. Earnings per share increased to \$.082 in 1997 as compared to \$.075 in 1996.

## **RISK FACTORS**

The film and television production and distribution industry is competitive and involves risk. To reduce this risk, the Company continues its conservative approach to financing by ensuring that at least 80% of the costs of each project are secured before commencing production.

The Company has participated in and benefited from federal and provincial government production tax credit programs and other incentives in Canada and in Europe, which are subject to change in the future. To reduce this exposure, the Company monitors foreign tax and film incentives and continues to produce its proprietary films under official co-production treaties with companies in European countries such as Ireland, Italy, and the Czech and Slovak Republics. In this way, the Company can benefit from European incentives and the reduced costs of location filming for its brand of historical period films.

The Company incurs expenses and licenses its television programs in currencies other than Canadian dollars. Foreign sales are customarily paid in U.S. dollars and production costs outside Canada are usually incurred in local currencies. As such, the Company may be affected by fluctuations in the exchange rates of the U.S. dollar and other foreign currencies. The Company reduces this risk by regularly reviewing the exchange rates of all the currencies that it expects to work with and will hedge through foreign exchange contracts in order to manage its foreign currency exposure where needed.

The Company's management has reviewed the possible risk associated with computers and the Year 2000. The Company has determined that all of its equipment and software is prepared for the Year 2000 date change. The Company expects that any date-sensitive problem that might arise can be resolved at a minimum cost that would be absorbed within normal operating budgets and without any interruption of the Company's business.

Devine Entertainment has an experienced senior management group, however it is substantially dependent upon the services of key individuals. The success of proprietary productions, acquisitions and expansion into related business areas depends on the skill and efforts of the Company's management.



## OUTLOOK

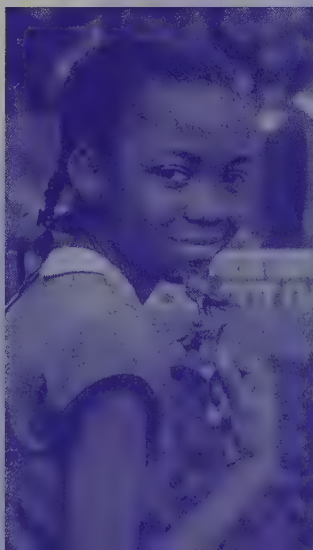
The Company's outlook for 1999 and into the future is positive and the Company expects revenues and profits to grow for a variety of reasons in 1999:

- Production revenues are expected to grow significantly. Contracted production revenues reflecting the delivery of four *Artists' Specials* are expected to be over \$2.3 million, an increase of over 35% in 1998, from the current HBO, YTV and TFO agreements alone. The Company also expects to increase foreign broadcast revenues as a result of a new agreement with Multimedia Group of Canada for *The Artists' Specials*. The Company also expects to benefit from an increase in production revenues in 1999 and 2000 resulting from its significant investment in the development of new series, mini-series and TV movies that began in 1998.
- Revenues from the Company's library are expected to continue to grow in 1999 as a result of packaging all nineteen *Composers'*, *Inventors'* and *Artists'* films as a long-running series of television specials internationally. As well, the Company expects to derive benefits from its new direct marketing distribution activities launched in 1998, including specialty marketing and joint ventures with Hal Leonard Corporation and PBS, as well as the development of the Company's own on-line store and edutainment internet channel, to launch in the third quarter of 1999.
- The Company expects that its commitment to growth by forming strategic alliances and the pursuit of M&A activities will benefit its shareholders by increasing the exploitation of its proprietary brand and library of films; increasing the Company's production output in the future; and allowing the Company to vertically integrate its production, distribution and marketing activities.

As Devine Entertainment Corporation maintains its focus on building its proprietary library of original family films, maximizing the revenue from the exploitation of its programs worldwide and developing new products based on its library, management believes that the Company's value will continue to grow.



Michael Moriarty as Galileo and Kenny Vadas as Prince Cosimo de Medici in *Galileo: On the Shoulders of Giants*.



Lataye Studwood as Lannie in *Einstein: Light to the Power of 2*.



# DEVINE ENTERTAINMENT CORPORATION

DECEMBER 31, 1998 AND 1997

## AUDITORS' REPORT

To the shareholders of DEVINE ENTERTAINMENT CORPORATION

We have audited the consolidated balance sheets of DEVINE ENTERTAINMENT CORPORATION as at December 31, 1998 and 1997 and the consolidated statements of operations and retained earnings and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

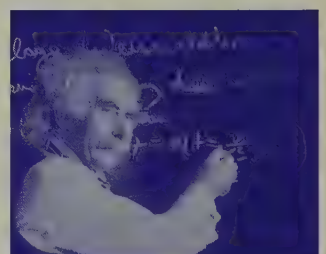
In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

*Chapman, Matten, Welton, Forster & Winter*

CHAPMAN, MATTEN, WELTON, FORSTER & WINTER

Chartered Accountants

Toronto, Canada  
February 27, 1999



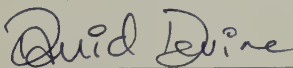



# DEVINE ENTERTAINMENT CORPORATION

## CONSOLIDATED BALANCE SHEETS

	December 31	
	1998	1997
<b>ASSETS</b>		
Cash and term deposits	\$ 243,058	\$ 527,506
Accounts receivable	718,301	828,964
Notes receivable - notes 2(c) and 3	2,528,325	2,528,325
Investment in film, television programs and recordings - notes 2(d) and 4	13,133,173	9,873,819
Film and television programs in progress - note 2(e)	967,430	1,168,636
Deferred charges - note 2(f)	18,603	27,905
Furniture and equipment - notes 2(g) and 5	87,109	112,949
Income tax and film tax credits receivable - notes 2(i) and 4	<u>1,598,234</u>	<u>1,802,000</u>
	<u>\$ 19,294,233</u>	<u>\$ 16,870,104</u>
<b>LIABILITIES</b>		
Bank loans - note 6	\$ 5,623,664	\$ 3,830,825
Accounts payable and accrued liabilities	307,790	333,261
Convertible debentures - note 7	585,811	585,811
Deferred revenue - note 2(b)	1,038,103	784,989
Deferred income taxes - note 2(j)	<u>1,401,600</u>	<u>1,236,000</u>
	<u>8,956,968</u>	<u>6,770,886</u>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock - note 12	8,269,057	8,269,057
Share option - note 7	322,203	322,203
Retained earnings	<u>1,746,005</u>	<u>1,507,958</u>
	<u>10,337,265</u>	<u>10,099,218</u>
	<u>\$ 19,294,233</u>	<u>\$ 16,870,104</u>

Approved on behalf of the Board

 Director

 Director

The accompanying notes are an integral part of these statements.



# DEVINE ENTERTAINMENT CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

	Year ended December 31	
	1998	1997
<b>REVENUE</b>	\$ 2,111,201	\$ 3,405,556
Costs of productions sold	66,667	368,335
Operating expenses	513,984	461,231
Amortization expense		
- film, television programs and recordings	802,805	844,538
- equipment	31,711	41,552
Interest expense - note 8	265,987	37,738
	<u>1,681,154</u>	<u>1,753,394</u>
<b>INCOME</b> (before income taxes)	430,047	1,652,162
Income taxes	<u>192,000</u>	<u>726,000</u>
<b>NET INCOME</b>	238,047	926,162
Opening retained earnings	<u>1,507,958</u>	<u>581,796</u>
<b>CLOSING RETAINED EARNINGS</b>	<u>1,746,005</u>	<u>\$ 1,507,958</u>
<b>NET INCOME PER COMMON SHARE</b> - note 13	\$ <u>0.021</u>	\$ <u>0.082</u>

The accompanying notes are an integral part of these statements.





# DEVINE ENTERTAINMENT CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOW

	Year ended December 31	
	1998	1997
<b>CASH PROVIDED BY (USED FOR)</b>		
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 238,047	\$ 926,162
Items not affecting cash:		
Amortization	834,516	886,090
Deferred income taxes	192,000	726,000
Net changes in other non-cash balances - Note 18	<u>(3,335,979)</u>	<u>(9,466,045)</u>
	<u>(2,071,416)</u>	<u>(6,927,793)</u>
<b>FINANCING ACTIVITIES</b>		
Loans and notes payable	1,792,839	(489,695)
Bank loans	<u>-</u>	<u>3,403,094</u>
	<u>1,792,839</u>	<u>2,913,399</u>
<b>INVESTING ACTIVITIES</b>		
Purchase of equipment	(5,871)	(12,196)
Notes receivable	<u>-</u>	<u>3,117,531</u>
	<u>(5,871)</u>	<u>3,105,335</u>
Decrease in cash	(284,448)	(909,059)
Cash and term deposits at beginning of year	<u>527,506</u>	<u>1,436,565</u>
Cash and term deposits at end of year	<u>\$ 243,058</u>	<u>\$ 527,506</u>

The accompanying notes are an integral part of these statements.



# DEVINE ENTERTAINMENT CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1998 AND 1997

### 1. NATURE OF BUSINESS

Devine Entertainment Corporation is an integrated developer and producer of high quality children's and family programs for worldwide television broadcast and home video markets.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of presentation

These consolidated financial statements include the accounts of Devine Entertainment Corporation and its wholly-owned subsidiaries, Devine Productions Ltd., Devine New Media Corporation., Devine Productions (Artists) Ltd., Devine Distribution Ireland and Devine Distribution International (US).

#### (b) Revenue recognition

Revenue is derived from broadcast licensing agreements, government grants, royalties, distribution fees, the sale of equity in productions, and the sale of distribution rights. Revenue from broadcast licensing agreements is recognized once the licensing periods have commenced, the programs are delivered and collection is reasonably assured. Revenue from government grants, royalties and distribution fees is recognized when received. Revenue from the sale of equity in productions and the sale of distribution rights is recognized when the film or television programs are substantially complete, the investors have irrevocably committed to acquire the related equity or distribution rights and there is reasonable assurance of collectibility of proceeds.

Amounts received and not recognized as revenue are recorded as deferred revenue.

#### (c) Notes receivable

Notes receivable from tax shelter limited partnerships are initially recorded at cost. Their collectibility is dependent on the limited partnerships' share of the cash flow from the exploitation of the films. Management reviews these projected cash flows, evaluates the cost of the notes on a periodic basis, and follows a policy of writing down their carrying value when the projected cash flows do not support the recovery of the net carrying amount. These reviews are subjective in nature and involve uncertainties and matters of significant judgement.

#### (d) Investment in film, television programs and recordings

Investment in film, television programs and recordings represents the unamortized costs of film, television programs and recordings which have been produced by the company or for which the company has acquired a copyright interest or the rights to future revenue. Such costs include development and production expenditures, capitalized financing costs and other costs which are expected to benefit future periods. The company uses the avoided cost method of capitalizing interest. The company also has an interest in programs which have been fully amortized in prior years and have no carrying value in these financial statements.



**(d) Investment in film, television programs and recordings (continued)**

Amortization is determined based on the ratio that current revenues earned from the programs bear to projected aggregate revenues. The investment is written down to the net recoverable amount if the carrying value is greater than the net recoverable amount. Net recoverable amount is defined as the total projected revenues to be earned from film, television programs and recordings, net of projected costs. The determination of the net recoverable amount is subjective in nature and involves uncertainties and matters of significant judgement.

**(e) Film and television programs in progress**

Film and television programs in progress represent the accumulated cost of incomplete film and television programs which are being produced by the company.

**(f) Deferred charges**

Financing costs are amortized on a straight-line basis over the terms of the debt obligations.

**(g) Furniture and equipment**

Furniture and equipment is recorded at cost less accumulated amortization. Amortization is provided using the diminishing balance method at an annual rate of 30% for computer and editing equipment, and 20% for furniture and fixtures.

**(h) Foreign currency translation**

Monetary assets and liabilities denominated in currencies other than Canadian dollars are translated at year end exchange rates. Revenue, expenses and film production costs are translated at the rates prevailing at the times of the transactions. The gains or losses resulting from these translations are reflected in the statements of operations.

**(i) Government assistance**

The Company has access to government programs and tax incentives that are designed to assist film and television producers in Canada. Government grants in respect of production assistance are recorded as revenue. Tax incentives which are based on film and television production costs are recorded as reductions of the related program costs.

**(j) Deferred income taxes**

Income taxes are accounted for on the tax allocation basis, under which the amount of income taxes payable for the year may differ from the total income tax provisions as a result of timing differences between the recording of amortization for accounting and income tax purposes. The tax effect of these differences is recorded as deferred income taxes.

**(k) Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates as additional information becomes available in the future. The assets which require management to make estimates and assumptions in determining their carrying values are primarily described in note 2(e) - Film and television programs in progress, note 3 - Notes receivable, and note 4 - Investment in film, television programs and recordings.

**3. NOTES RECEIVABLE**

These notes are non-interest bearing, due on demand and are secured by a security interest in "The Composers' Specials" television programs.



#### 4. INVESTMENT IN FILM, TELEVISION PROGRAMS AND RECORDINGS

December 31

	1998	1997
Film, television programs and recordings	\$ 14,867,431	\$ 10,805,272
Less accumulated amortization	<u>1,734,258</u>	<u>931,453</u>
	<u>\$ 13,133,173</u>	<u>\$ 9,873,819</u>

The Company has reduced its investment in film and television programs by anticipated production tax credits in the amount of \$2,212,000. The Company also earns revenues from film and television programs which are not valued in the accounts.

#### 5. FURNITURE AND EQUIPMENT

	1998		1997	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Computer and editing equipment	\$ 154,575	\$ 92,362	\$ 149,645	\$ 66,757
Furniture and fixtures	<u>55,082</u>	<u>30,186</u>	<u>54,141</u>	<u>24,080</u>
	209,657		203,786	
	<u>122,548</u>	<u>\$ 122,548</u>	<u>90,837</u>	<u>\$ 90,837</u>
	<u>\$ 87,109</u>		<u>\$ 112,949</u>	

#### 6. BANK LOANS

December 31

	1998	1997
Term loan bearing interest at 1.5% above Royal Bank prime, repayable in monthly payments of \$2,115 plus interest, secured by an editing computer system.	\$ 44,395	\$ 71,890
Term loan, bearing interest at 6.75% per annum, repayable in monthly payments of \$4,200 plus interest, secured by a general security agreement, an assignment of insurance and guarantees by the officers of the company for \$30,000	142,800	193,200
Demand loan to a maximum of \$660,000, bearing interest at 2% above Royal Bank prime, secured by a general security agreement, an assignment of accounts receivable, specific assignments and notices of assignment of funds owing by a broadcaster and a distributor, assignment of tax refunds, assignment of all risk insurance and Errors and Omissions insurance proceeds, limited guarantee and postponement of claim in the amount of \$500,000, and a security interest in all rights in and to three Episodes of "The Artists' Specials" television programs	478,595	-



## 6. BANK LOANS (continued)

Demand loans bearing interest at 1.5% above Royal Bank prime, secured by a first general security agreement, assignment, direction and acknowledgement agreements in respect of each of the license agreements, pecuniary loss indemnity, postponement of guarantors' claims, completion bond, assignment of all risk, errors and omissions insurance proceeds, assignment of Federal and Ontario Tax Credits, assignment of Mortgage of Distributor's Rights, assignment of copyright and any and all future revenue with respect to commercial exploitation of "The Inventors' Specials" television programs, and a security interest in all rights in and to "The Inventors' Specials" television programs

4,957,874	3,565,735
<u>\$ 5,623,664</u>	<u>\$ 3,830,825</u>

Interest on the above term loans totalled \$16,052 (1996-\$20,590)

## 7. CONVERTIBLE DEBENTURES

December 31

	1998	1997
Principal		
Issued		
- December 1995	\$ 835,800	\$ 835,800
- February 1996	100,000	100,000
	<u>935,800</u>	<u>935,800</u>
Less		
- equity component	(322,203)	(322,203)
- unamortized equity component issue costs	<u>(27,786)</u>	<u>(27,786)</u>
	<u>\$ 585,811</u>	<u>\$ 585,811</u>

- (i) The Company issued 11,250 units of Debentures and Warrants in December 1995 for \$1,125,000 less costs of \$100,000, for net proceeds to the company of \$1,025,000. Each unit consists of a \$100 Debenture and 25 immediately separable Warrants.

The 7.5% Redeemable Convertible Subordinated Debentures mature on December 31, 2000, bear interest at an annual rate of 7.5% payable semi-annually, and are redeemable by the company upon 30 days written notice following any period of 20 consecutive trading days, ending not more than 5 trading days prior to the date on which notice of redemption is given, during which the weighted average market price of the company's common shares over such 20 day period equals or exceeds \$2.00, subject to adjustment in certain events. The Debentures are convertible at the holders' option into common shares at any time prior to maturity or, if called for redemption, on or before the last business day preceding the date specified for redemption, at a conversion rate of \$1.50 per share, being a rate of 67 common shares for each \$100 principal amount of Debenture, subject to adjustment in certain circumstances. The Debentures are subordinated to certain senior indebtedness of the company. Interest for the years ended December 31, 1998 and 1997 totalled \$62,685 and \$70,455 respectively. The annual interest requirement on the remaining Debentures is \$62,685.

## 7. CONVERTIBLE DEBENTURES (continued)

- (ii) The Company issued a \$100,000 Redeemable Convertible Subordinated Debenture in February, 1996. This Debenture matures on December 31, 2000, bears interest at an annual rate of 7.5% payable semi-annually, and is redeemable by the company upon 30 days written notice following any period of 20 consecutive trading days, ending not more than 5 trading days prior to the date on which notice of redemption is given, during which the weighted average market price of the company's common shares over such 20 day period equals or exceeds \$2.00, subject to adjustment in certain events. The Debenture is convertible at the holder's option into common shares



at any time prior to maturity or, if called for redemption, on or before the last business day preceding the date specified for redemption, at a conversion rate of \$1.50 per share, being a rate of 67 common shares for each \$100 principal amount of Debenture, subject to adjustment in certain circumstances. The Debenture is subordinated to certain senior indebtedness of the Company. The annual interest requirement on the Debenture is \$7,500. Assuming the conversion of the Debenture, the maximum number of shares issuable is 67,000.

- (iii) The fair value, at the time of issue of the Debentures, of the Company's obligation to make future payments of principal and interest, was \$766,850 (\$704,250 in 1995 and \$62,600 in 1996). The fair value of the holders' conversion options was \$458,150 (\$420,750 in 1995 and \$37,400 in 1996). The liability carries an effective interest rate of 20%.

## 8. INTEREST EXPENSE

	1998	1997
Interest expense on long term debt	\$ 86,237	\$ 98,545
Interest income	(19,943)	(23,292)
Other	<u>340,758</u>	<u>437,354</u>
	407,052	512,607
Less: interest capitalized to film and television programs	<u>(141,065)</u>	<u>(474,869)</u>
	<u>\$ 265,987</u>	<u>\$ 37,738</u>

## 9. INCOME TAXES

Income taxes have been provided for using the Company's combined federal and provincial statutory income tax rate of 44%.

## 10. FINANCIAL INSTRUMENTS

Fair values approximate amounts at which financial instruments could be exchanged between willing parties, based on current markets for instruments of the same risk, principal and remaining maturities. Fair values are based on estimates using valuation techniques which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows which reflect varying degrees of risk.

Therefore, due to the use of subjective judgement and uncertainties, the aggregate fair value amount should not be interpreted as being realizable in an immediate settlement of the instruments.

As at December 31, 1998 and 1997, the Company's financial instruments included cash and term deposits, accounts receivable, notes receivable, income tax and film tax credits receivable, bank loans, accounts payable and accrued liabilities, and convertible debentures.

### (i) Fair value

The carrying values of cash and term deposits, accounts receivable, income tax and film tax credits receivable, bank loans, and accounts payable and accrued liabilities approximate fair values because of their maturity and normal credit terms.

The fair value of the convertible debentures has been estimated by first calculating the present value of the liability component, and then assigning to the equity component the difference between the proceeds of the debenture and the fair value of the liability component.

The notes receivable arise from the sale of "The Composers' Specials" to a tax shelter limited partnership and, as such, fair market value information is not readily available. The determination of fair value is subjective in nature and involves uncertainties and matters of significant



judgement. Management is of the opinion that the fair value approximates cost and that no adjustment to carrying value is required.

(ii) Credit risk

The Company's accounts and notes receivable are subject to credit risk. The Company continually monitors its positions with and credit quality of the organizations which are counterparty to its accounts receivable and does not anticipate non-performance. The notes receivable are secured by a security interest in "The Composers' Specials" television programs.

## 11. COMMITMENT

The Company leases its premises at an annual rental of \$12,000 in addition to various occupancy costs under an agreement expiring May 31, 1999.

## 12. CAPITAL STOCK

(a) Authorized - an unlimited number of common shares and Class A shares.

(b) Issued - common shares	<u>Number</u>	<u>Amount</u>
Outstanding as at December 31, 1996	11,314,761	\$ 8,093,281
- Conversion of debentures at \$1.50 per share	132,064	198,100
Less issue costs	-	(22,324)
Outstanding as at December 31, 1997 and 1998	<u>11,446,825</u>	<u>\$ 8,269,057</u>

(c) Options	<u>Number of Shares</u>
Balance at December 31, 1996	1,374,575
Issued during the year	50,000
Expired during the year	(434,575)
Balance at December 31, 1997	990,000
Issued during the year	187,000
Expired during the year	(270,000)
Balance at December 31, 1998	<u>907,000</u>

Options outstanding at December 31, 1998 are as follows:

<u>Number of Shares</u>	<u>Expiry Date</u>	<u>Exercise Price</u>
310,000	June 28, 1999	\$1.50
40,000	February 20, 1999	\$1.50
310,000	June 28, 1999	\$1.75
40,000	February 20, 1999	\$1.75
17,000	February 17, 2001	\$1.50
<u>190,000</u>	April 30, 2003	\$1.50
<u>907,000</u>		

## 13. EARNINGS PER COMMON SHARE

Earnings per common share have been calculated using the weighted average number of participating shares outstanding during the relevant period. For the year ended December 31, 1998 the weighted average number of participating shares outstanding was 11,446,825 (1997 - 11,359,219). No material dilution of these per share amounts would result if all the outstanding options and warrants were exercised.

## 14. RELATED PARTY TRANSACTIONS

The costs of film and television programs in progress include \$352,000 (1997-\$455,000) for writing, direction and production services paid to a company controlled by two of the directors, and



\$108,000 (1997 - \$132,500) for production services paid to an officer. The Company believes that these amounts reflect prevailing market rates.

#### 15. GOVERNMENT GRANTS

The Company obtained \$250,000 (1996 - \$501,712) in government grants during the year which has been recorded as revenue.

#### 16. SEGMENTED INFORMATION

Revenue includes \$1,566,000 (1996 - \$1,662,000) derived from foreign sources.

#### 17. DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IN CANADA AND THE UNITED STATES (US)

The consolidated financial statements of the Company have been prepared in accordance with Canadian GAAP. The following adjustments and/or additional disclosures would be required in order to present the financial statements in accordance with US GAAP.

- (a) Under US GAAP, the Company would recognize deferred tax liabilities and assets at current tax rates, whereas under Canadian GAAP, timing differences are tax effected at the rates in effect when they arise. The Company has determined that there would be no difference in measurement of income taxes between US and Canadian GAAP.
- (b) Under US GAAP, primary earnings per share would be calculated using the weighted average number of common shares and common shares equivalents, as opposed to the weighted average number of common shares under Canadian GAAP. Options and warrants, however, which would normally be considered common stock equivalents under US GAAP, have an antidilutive effect on the calculation of earnings per share for each of the years presented and as a result, there is no difference between earnings per share figures under Canadian and US GAAP.

#### 18. NET CHANGES IN OTHER NON-CASH BALANCES

	1998	1997
Decrease (increase) in accounts receivable	\$ 110,663	\$ (242,175)
Increase in film, television programs and recordings	(3,851,651)	(6,625,033)
Decrease (increase) in income tax and film tax credits receivable	203,766	(1,866,000)
Decrease in accounts payable and accrued liabilities	(25,471)	(199,455)
Increase (decrease) in deferred revenue	253,114	(533,382)
Decrease in deferred income taxes	(26,400)	-
	<u>\$ (3,335,979)</u>	<u>\$ (9,466,045)</u>

#### 19. YEAR 2000

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effect of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.





## DEVINE ENTERTAINMENT CORPORATION

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**Coming in September, our new  
educational website timelining  
history: [www.devinetime.com](http://www.devinetime.com)**



## CORPORATE & SHAREHOLDER INFORMATION:

### DIRECTORS AND OFFICERS

#### DAVID DEVINE

Chairman of the Board  
President & Chief Executive Officer

#### RICHARD MOZER

Vice-Chairman of the Board  
Chief Financial Officer

#### KENNETH TAYLOR

Chairman, Global Public Affairs Inc.

#### WILLIAM BALLARD

President, Step Entertainment

#### BRYSON FARRILL

Financial Consultant

### STOCK EXCHANGE LISTING

Toronto Stock Exchange - DVN

### REGISTRAR AND TRANSFER AGENT

#### Montreal Trust

600, 530 - 8th Avenue S.W.  
Calgary, AB T2P 3S8

### LEGAL COUNSEL

Wildeboer Rand Thomson Apps & Dellelce

### AUDITORS

Chapman, Matten, Welton, Forster & Winter

### BANKERS

Royal Bank of Canada

### ANNUAL MEETING OF SHAREHOLDERS WEDNESDAY JUNE 23, 1999 AT 4:15 P.M.


Cambridge Suites Hotel, Club Room  
15 Richmond Street East  
Toronto, Ontario



**Karl Pruner as Isaac Newton in *Newton: A Tale of Two Isaacs***

**Back Cover: Alison Pill as Marie in *Degas and the Dancer***





ANNUAL REPORT 1998

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